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AIRPORT COMMISSION:

Concession Audit of WSE Group, Inc., dba Legends of San Francisco

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April 9, 2009

City and County of San Francisco

Office of the Controller – City Services Auditor

AIRPORT COMMISSION:

Concession Audit of WSE Group, Inc., dba Legends of San Francisco

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April 9, 2009

**CONTROLLER'S OFFICE
CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Mark Tipton, Audit Manager
Renato Lim, Associate Auditor



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

April 9, 2009

San Francisco Airport Commission
P.O. Box 8097
San Francisco International Airport
San Francisco, CA 94128

President and Members:

The Controller's Office, City Services Auditor, presents its report concerning the audit of WSE Group, Inc., doing business as (dba) Legends of San Francisco (Legends). Legends has a 10-year lease agreement, through December 24, 2015, with the Airport Commission of the City and County of San Francisco (City) to operate a casual dining and bar facility in Terminal 1 of San Francisco International Airport (Airport).

Reporting Period: July 1, 2005, through June 30, 2008

Rent Paid: \$332,086

Results:

- Legends correctly reported monthly gross revenues, and correctly paid monthly rent.
- Legends sometimes paid its rent late, resulting in service charges due of \$1,885.
- Legends currently has \$1,256 in overdue utility and storage rent payments to the Airport.
- Both Legends and the Airport failed to comply with various miscellaneous requirements of the lease agreement.

The responses of the Airport and Legends are attached to this report. Also attached is a rebuttal to Legends' response, in which we explain that we disagree with one point in Legends' response and clarify our position on another point in Legends' response. The Controller's Office, City Services Auditor will work with the Airport to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Robert Tarsia
Deputy Audit Director

cc: Mayor
Board of Supervisors
Budget Analyst
Civil Grand Jury
Public Library

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INTRODUCTION

Audit Authority

The Office of the Controller (Controller) has authority under the San Francisco Administrative Code, Chapter 10, Article 1, Section 10.6-2 to audit, at regular intervals, all leases of City-owned real property where rent of \$100,000 or more per year is to be paid to the City. In addition, the City Charter provides the Controller, City Services Auditor (CSA), with broad authority to conduct audits. We conducted this audit under that authority and pursuant to an audit plan agreed to by the Controller and the Airport.

Background

WSE Group, Inc. dba Legends of San Francisco (Legends) has a 10-year lease agreement (lease) with the Airport Commission (Commission) of the City and County of San Francisco (City). The lease, which has a rent commencement date of December 24, 2005, allows Legends to operate a casual dining and bar facility in Terminal 1 of San Francisco International Airport (Airport). The lease also requires Legends to pay the Airport monthly the greater of one-twelfth of a minimum annual guarantee (MAG) or a tiered percentage rent of between 8 to 12 percent of its gross revenues. The percentage rent tiers are contingent on the amount of Legends' total gross revenues per lease year. During our audit period, the monthly MAG rent was \$3,583 from December 24, 2005, through March 31, 2007; \$3,767 from April through December 2007; and \$3,892 from January through June 2008.

Scope and Methodology

The purpose of this audit was to determine if the monthly statements of gross revenues that Legends submitted to the Airport accurately reflected actual gross revenues based on monthly and daily records; if Legends paid the proper amount of rent to the Airport, according to the terms of its lease; if Legends currently has no overdue rent payable to the Airport for the audit period; and if Legends complied with the other provisions of its lease.

Our audit covered the period July 1, 2005, through June 30, 2008.

To conduct the audit, we examined the applicable terms of the lease and the adequacy of Legends' procedures for collecting, recording, summarizing, and reporting its gross revenues to the Airport. To determine whether Legends

accurately reported its gross revenues to the Airport, we compared its reported gross revenues to those recorded in its internal monthly summary records on a sample basis. We then tested, on a sample basis, Legends' internal monthly summary records to daily sales reports and other specific source documents. To determine whether Legends had any outstanding rent or other payments due to the Airport for the audit period, we examined the Aged Accounts Receivables Report from the Airport's Accounting Department. To determine whether Legends complied with other provisions of the lease, we selected key lease requirements and performed inquiry, observation, and testing to substantiate compliance with those lease provisions.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Legends Correctly Reported Its Gross Revenues and Calculated Its Rent But Did Not Always Pay Its Rent on Time

For the audit period July 1, 2005, through June 30, 2008, Legends correctly reported its gross revenues of \$3,592,621 and correctly calculated and paid its rent of \$332,086. However, Legends often paid late its minimum monthly rent. Section 4.3 of the lease requires the monthly minimum annual guarantee (MAG) rent payment by the first day of each month. Legends made these payments late for 13 (42 percent) of the 31 months in the audit period for which rent was due. (Legends did not begin operations until December 2005.)

Besides the monthly MAG rent, Legends owed and paid monthly rent calculated as a percentage of gross revenues. The lease requires Legends to make these percentage rent payments by the 20th of each month for the preceding month, and each monthly invoice from the Airport states that a 1.5 percent service charge will be assessed on late remittances. Legends paid its percentage rent late for 10 (32 percent) of the 31 months in the audit period.

The Airport did not apply service charges to Legends' late rent payments. Had the Airport done so, the late fees would have totaled \$1,885.

EXHIBIT	Gross Revenues Reported and Rent Paid July 1, 2005, Through June 30, 2008
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Reporting Period	Gross Revenues	Rent Paid
July 1, 2005 through June 30, 2006*	\$ 566,731	\$ 36,006
July 1, 2006 through June 30, 2007	1,354,498	125,800
July 1, 2007 through June 30, 2008	1,671,392	170,280
Total	\$3,592,621	\$332,086

*Note: Legends did not begin operating until December 2005, at which time it was required to begin paying rent.

Sources: Airport accounting monthly sales reports and FAMIS cash receipts report.

Legends Has \$1,256 in Overdue Utility and Storage Space Rent Payments

Airport accounting records show Legends has not paid a \$932 utility bill, invoiced in April 2006, and a \$324 storage unit rent bill, invoiced in December 2007. Legends disputes the Airport's claim that the amounts have not been paid and, as of February 2009, the Airport and Legends were still working to resolve the disputed billings.

**Legends and the Airport
Did Not Comply With
Certain Lease Provisions**

In addition to requiring Legends to report its gross revenues and calculate and pay its rent due, the lease requires both Legends and the Airport to comply with other provisions. As described below, both parties to the lease failed to comply with some lease provisions.

**Legends Paid Its
Infrastructure Fees Late**

Section 4.9 of the lease stipulates that infrastructure fees¹ be paid to the Airport on the first day of each month. Because both the monthly MAG rent and the infrastructure fees are due on the same day each month, the Airport bills both amounts on the same invoice, and Legends pays both amounts at the same time. Thus, because Legends paid its monthly MAG rent late for 13 months of the audit period, it also paid its infrastructure fees late. However, the lease does not provide for service charges for late infrastructure fee payments, so no late charges are due.

**Legends No Longer
Certifies Its Monthly
Sales Reports**

Since April 2008, Legends has not been certifying the monthly sales reports it submits to the Airport. Submitting these reports monthly, and having them certified by the tenant, is required by Section 4.4 of the lease.

**The Airport Did Not
Waive or Otherwise
Amend the Lease
Provision for the Rent
Commencement Date**

One provision of the lease stipulates that rent must begin no later than 90 days after the lease's commencement date. However, another provision states the rent commencement date in the lease is December 24, 2005, nearly six months after the lease's commencement date of June 28, 2005. The two provisions therefore present contradictory rent commencement dates, possibly implying that the Airport did not receive rent from October through December. The December 24th rent commencement date resulted from the tenant being unable to remodel the premises and open for business as soon as first anticipated. But the Airport did not waive the 90-day requirement of the first provision in writing, resulting in the contradiction.

Recommendations

The Airport Department should take the following actions:

1. Invoice Legends for rent service charges of \$1,885 for numerous late monthly rent payments.

¹ Infrastructure fees are charged by the Airport to tenants for the recoupment of costs incurred by the Airport for installing electrical, plumbing, and other utility infrastructure in tenant spaces.

2. Going forward, assess all late payment and other service charges required by Legends' lease.
3. Work with Legends to resolve the disputed \$1,256 in utility and storage rental unit billings. Specifically, either collect the appropriate amounts from Legends, or credit Legends for the appropriate amounts. If these amounts are found to be due, assess the corresponding late payment charges.
4. Remind Legends to remit on time its monthly rent due, both the monthly minimum rent and the percentage rent, with or without the Airport's billed invoice.
5. Remind Legends to remit on time its fees due, such as its infrastructure fees, with or without the Airport's billed invoice.
6. Require Legends to certify its monthly sales reports.
7. In the future, to avoid incompatible or conflicting lease provisions, ensure that leases are amended or lease provisions are waived in writing, when needed, to reflect current arrangements agreed to by the Airport and tenant.

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ATTACHMENT A: AIRPORT'S RESPONSE



San Francisco International Airport

April 1, 2009

TO: Mr. Robert Tarsia
FROM: Mr. Robert Tarsia
SUBJECT: Audit of Domestic Terminals Food and Beverage Lease No. 05-0075
WSE Group, Inc. Inc dba Legends of San Francisco - Airport's Response

Mr. Robert Tarsia
Deputy Audit Director
Office of the Controller
City and County of San Francisco
City Hall, Room 476
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

AIRPORT
COMMISSION
CITY AND COUNTY
OF SAN FRANCISCO

Subject: Audit of Domestic Terminals Food and Beverage Lease No. 05-0075
WSE Group, Inc. Inc dba Legends of San Francisco - Airport's
Response

ADMINISTRATIVE
SERVICES

Dear Mr. Tarsia:

ADMINISTRATIVE
SERVICES

This letter supersedes my March 19, 2009 correspondence to you.

ADMINISTRATIVE
SERVICES

The San Francisco International Airport ("Airport") is in receipt of the Audit Recommendation from City Services Auditor Division for its audit of Lease No. 05-0075 ("Lease") between the City and County of San Francisco, through its Airport Commission, and WSE Group, Inc. ("Tenant"). The following is the Airport's response to the Audit Report findings:

ADMINISTRATIVE
SERVICES

ADMINISTRATIVE
SERVICES
CITY AND COUNTY
OF SAN FRANCISCO

1. **Invoice Legends for rent service charges of \$1,885 for numerous late monthly rent payments.** As a current policy and practice, Airport does not charge late fees on rent payments.
2. **Going forward, assess all late payment and other service charges required by Legends' lease.** As a current policy and practice, Airport does not charge late fees on rent payments.
3. **Work with Legends to resolve the disputed \$1,256 in utility and storage rental billings.** Specifically, either collect the appropriate amounts from Legends, or credit Legends for the appropriate amounts. If these amounts are found to be due, assess the corresponding late payment charges. Revenue Development and Management will coordinate with Airport Accounting to resolve and determine if Tenant owes past due amounts or credit Tenant for overpayment.

Robert Tarsia
April 1, 2009
Page 2

4. **Remind Legends to remit on time its monthly rent due, both the monthly minimum rent and the percentage rent, with or without the Airport's billed invoice.** Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.
5. **Require Legends to certify its monthly sales reports.** Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.
6. **In future, to avoid incompatible or conflicting lease provisions, ensure that leases are amended or lease provisions are waived in writing when needed to reflect current arrangements agreed to by the Airport and tenant.** Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.

Thank you for your staff's work on this audit. Please do not hesitate to call if you have any questions.

Sincerely,



Cheryl Nashir
Associate Deputy Airport Director
Revenue Development & Management

cc: Renato Lim
Leo Fermin
Cesar Sanchez
Gigi Ricasa
Sharon Perez

Recommendation	Responsible Agency	Response
1. Invoice Legends for rent service charges of \$1,885 for numerous late monthly rent payments.	AIR	As a current policy and practice, Airport does not charge late fees on rent payments.
2. Going forward, assess all late payment and other service charges required by Legends' lease.	AIR	As a current policy and practice, Airport does not charge late fees on rent payments.
3. Work with Legends to resolve the disputed \$1,256 in utility and storage rental billings. Specifically, either collect the appropriate amounts from Legends, or credit Legends for the appropriate amounts. If these amounts are found to be due, assess the corresponding late payment charges.	AIR	Revenue Development and Management will coordinate with Airport Accounting to resolve and determine if Tenant owes past due amounts or credit Tenant for overpayment.
4. Remind Legends to remit on time its monthly rent due, both the monthly minimum rent and the percentage rent, with or without the Airport's billed invoice.	AIR	Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.
5. Remind Legends to remit on time its fees due, such as its infrastructure fees, with or without the Airport's billed invoice.	AIR	Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.
6. Require Legends to certify its monthly sales reports.	AIR	Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.

Recommendation	Responsible Agency	Response
<p>7. In the future, to avoid incompatible or conflicting lease provisions, ensure that leases are amended or lease provisions are waived in writing, when needed, to reflect current arrangements agreed to by the Airport and tenant.</p>	<p>AIR</p>	<p>Revenue Development and Management agrees with this statement. Staff will ensure compliance going forward.</p>

ATTACHMENT B: LEGENDS' RESPONSE



March 31, 2009

Mr. Robert Tarsia
Deputy Audit Director
Office of the Controller
City and County of San Francisco
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102

Subject: Audit of Lease #05-0075 Legends of San Francisco

Dear Mr. Tarsia:

WSE Group, Inc. is in receipt of the Auditor Recommendations from the audit of Lease #05-0075.

The following is our response to the auditor's findings

- **Late rent payments** – Dec.2005 and Jan.2005 rent was not invoiced to us until 1-17-06 on Inv#IRAC613-0182 and not due until 2-1-06 (see Exhibit A). This invoice was paid within terms. We are somewhat in agreement with the findings on the remaining invoices that were flagged as received late. Maybe we should have hand delivered these payments to avoid postal service and posting delays.
- **Legends overdue utility & storage rent payments** – The \$931.84 outstanding utility bill in question was paid 6-22-06 check #11439. The total amount of check #11439 was \$4483.05 and cleared our bank on 6-26-06 (see Exhibit B). I believe the storage rent payments in question resulted from when our storage unit location was changed by the airport to accommodate Southwest Airlines coming to San Francisco Airport. We paid our storage space rent each month (see Exhibit C).

FOOD SERVICES, RESTAURANT AND CONCESSION MANAGEMENT
533 AIRPORT BLVD., SUITE 523, BURLINGAME, CALIFORNIA 94010 TEL: 650/348-0556 FAX 650/348-0557

- **Legends no longer certifies monthly sales reports** - It was brought to our attention that the monthly sales reports for April thru December 2008 did not contain a certification signature. We have corrected this error.

Please do not hesitate to give me a call at (650)348-0556 should you have any questions. Thank you to your staff for the professionalism in which this audit was conducted.

Regards,



Robbi Hollon
Controller

cc: Renato Lim
Jose Placencia

Attachments

Note: Exhibits referred to in this letter were provided to the Airport but are not presented here.

ATTACHMENT C: CITY SERVICES AUDITOR REBUTTAL TO LEGENDS' RESPONSE

To provide clarity and perspective, the Controller's Office, City Services Auditor Division, is commenting on Legends' letter responding to our audit report (Attachment B). This rebuttal corresponds to the first two bulleted items in Legends' letter.

Late rent payments - The letter refers to "Dec. 2005 and Jan. 2005 rent..." which is incorrect. This should state December 2005 and January 2006 rent. Moreover, as stated in the report, the lease requires that the monthly minimum annual guarantee (MAG) rent is due on the first day of each month. Therefore, the tenant must pay its monthly MAG rent on or before the first of the month regardless of when or if the Airport invoices the tenant. According to the Airport's response (Attachment A), the Airport will not apply late fees to the late rent payments identified in this audit.

Overdue utility & storage space rent payments - We acknowledge receipt of the documents referenced in Attachment B. We have forwarded those documents to the Airport and recommend, as stated in the report, that the Airport and Legends resolve this matter directly.

